Ontario

THE FUNDING OF JOINTLY-SPONSORED DEFINED BENEFIT PENSION PLANS

A CONSULTATION PAPER

Ministry Of Finance
August, 2005

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FOREWORD

In the 2005 Ontario Budget, the Minister of Finance announced that the ministry would issue a consultation paper which would focus on the funding of jointly-sponsored defined benefit pension plans (JSPs) and potential areas of conflict between the terms of these plans and the *Pension Benefit Act* (PBA).

The PBA was written with traditional sole sponsorship defined benefit pension plans in mind where the employer is solely responsible for making special payments in respect of a going concern unfunded liability or solvency deficiency. The PBA assumes that plan members are not responsible for making such payments.

With the establishment of JSPs, conflicts may exist between some of the provisions of these plans and the PBA requirements. In order to assess these conflicts, the province is providing this consultation paper which identifies the areas of conflict and proposes solutions. While the focus of this paper is on JSPs, there are a few proposals, regarding transfer deficiencies and actuarial cost methods, which would apply to all defined benefit pension plans. Legislation to amend the PBA to address these issues will be introduced in the fall and, if approved by the legislature, it is expected that the changes will be in effect before year-end. Amendments to the PBA Regulation would also be required.

The proposals set out in this paper provide a possible direction for the amendments. The government is interested in the views of stakeholders and will carefully consider all comments before finalizing the amendments to the PBA and the Regulation.

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LIST OF PROPOSALS AND QUESTIONS

PROPOSALS

1. Amend the Pension Benefits Act (PBA) to provide the authority to define a new class of pension plans as "jointly-sponsored pension plans" in the Regulation.

2. Amend the PBA and the Regulation to provide that the documents that create and support a jointly-sponsored pension plan shall provide that plan members are required to make special payments to amortize a going concern unfunded liability and solvency deficiency.

3. Amend the PBA and the Regulation to include plan members in the list of persons who may be required to make contributions under a pension plan (including special payments to amortize a going concern unfunded liability and solvency deficiency) and if plan members are so required to make contributions, to ensure that pension plans set out that obligation.

4. Amend the Regulation under the PBA to permit both sponsors (plan members and employers) of jointly-sponsored defined benefit pension plans to finance a going concern unfunded liability by a level percentage of the projected pensionable earnings of the members of the pension plan on the date of the establishment of the payment schedule over a period not to exceed 15 years. This rate would be paid in the future by both existing members and new entrants.

5. Amend the Regulation under the PBA to permit both sponsors (plan members and employers) of jointly-sponsored defined benefit pension plans to finance a solvency deficiency as a level percentage of projected pensionable earnings of the members of the pension plan on the valuation date over a period not to exceed five years. This rate would be paid in the future by both existing members and new entrants.

6. Amend the Regulation under the PBA to permit both sponsors (plan members and employers) of jointly-sponsored defined benefit pension plans to finance a going concern unfunded liability or solvency deficiency through special payments calculated as a level percentage of projected pensionable earnings (starting no later than 12 months after the valuation date), together with appropriate adjustments for interest, rather than paying the amount in arrears as a lump sum including interest.

7. Amend the Regulation under the PBA to expressly permit the use of actuarial cost methods in funding reports submitted to the Superintendent that are not based on benefit allocation methods. This right would be subject to the condition that the present value of the difference between the contributions determined under the method used by the plan and the normal cost as defined in the Regulation not be less than the present value of the remaining special payments for unfunded liabilities under the Regulation, subject to the application of any actuarial gains. The period over which the present values are calculated would be the longest amortization period of an unfunded liability and/or solvency deficiency.

8. Amend the Regulation under to PBA to require that all pension plans that are valued using a method different from the benefit allocation method, must also calculate the "normal cost", "going concern unfunded liability" and "solvency deficiency" using a benefit allocation method in order to determine the minimum funding requirements as currently prescribed.

9. Amend clause 19(6)(b) of the Regulation to remove the condition related to individual transfers and permit plan members to receive their full commuted value on termination of plan membership or employment if the sum of the value of all transfer deficiencies and excluded liabilities does not exceed 5 per cent of the assets of the pension plan, provided that all other PBA requirements are met, and repeal subsection 19(9) for all plans.

10. Amend section 34 of the PBA by adding "other prescribed person or entity" in addition to an employer in order to address circumstances in which the pension plan is jointly-sponsored and the documents which create and support the plan do not assign the responsibility to establish a separate pension plan to the employer.

11. Amend subsection 40(3) of the PBA to provide that where the consent of the plan administrator is an eligibility requirement for entitlement to receive an ancillary benefit and a member has met all other eligibility requirements, the administrator is deemed to have given the consent to the member.

12. Exempt a plan administrator who acts both as administrator and trustee of the pension fund from the requirement in the Regulation to provide the pension fund trustee with a summary of contributions required to be made in the next fiscal year.

13. Amend subsection 68(1) of the PBA to provide that a pension plan may be wound up in whole or in part by the person or entity which is assigned this responsibility in the documents which create and support the pension plan.

14. **Repeal sections 12.1 and 12.2 of the *Teachers' Pension Act* on the date on which the amendments to the PBA and the Regulation come into force.**

15. **Amend the PBA to extend the deadline for filing actuarial valuations for inter-valuation reports with a valuation date between December 31, 2004 and June 30, 2005 until March 31, 2006 and apply the proposed amendments in this Consultation Paper to those valuations which are filed by the new deadline for jointly-sponsored defined benefit pension plans only. Specific details will be included in the legislation to be introduced this fall.**

QUESTIONS

1. **Could subsections 19(4) and (5) of the Regulation under the PBA be amended in a manner which maintains the balance in interests between departing and remaining members, simplifies the requirements for plan administrators and reduces the regulatory burden? Please be as specific as possible.**

2. **Are there any issues relating to jointly-sponsored defined benefit pension plans which have not been covered in this paper that need to be addressed?**

1. INTRODUCTION

In the early 1990s, a number of jointly-sponsored defined benefit pension plans (JSPs) were established, mainly in the public sector. Most of these plans are contributory defined benefit plans in which pension benefits are based on final average earnings. Many of these plans are multi-employer pension plans (MEPPs) established by a statute, trust or collective agreement, rather than traditional single employer defined benefit plans.

Under these arrangements, both employers and plan members contribute to the plans in respect of the plans' normal cost as defined under the *Pension Benefits Act* (PBA). They also share in the responsibility for making special payments to finance any going concern unfunded liability, solvency deficiency, or both. Although MEPPs established through a trust or collective agreement are not subject to the prohibition against reducing accrued benefits in section 14 of the PBA, JSPs typically address a going concern unfunded liability or solvency deficiency through special payments rather than benefit reductions.

The PBA was substantially re-written in 1986. It was written with traditional employer-sponsored defined benefit pension plans in mind where the employer or a person who makes contributions on behalf of the employer is the sole sponsor of the pension plan. Under these arrangements, an employer or a person required to make contributions on behalf of an employer is solely responsible for making special payments in respect of a going concern unfunded liability or solvency deficiency. It was assumed that plan members would not be responsible for making such payments.

The PBA predates the establishment of many JSPs. When the PBA was amended in 1986, there were a small number of JSPs with a small number of members. JSPs are now much more numerous and they represent a very significant proportion of all pension plan members in Ontario (in 2004, the five largest JSPs represented about one-third of the members of all pension plans registered in Ontario).

Inconsistencies exist between some of the provisions of these plans and the requirements of the PBA. This is because it is difficult to implement PBA provisions designed for sole sponsorship arrangements in a joint sponsorship arrangement. For example, subsection 55(2) and section 75 of the PBA (respecting funding requirements) do not even mention funding obligations by plan members. Similarly, section 4 of the Regulation under the PBA makes no mention of the possibility that plan members might be responsible for making special payments.

Funding JSPs and PBA Compliance

The fact that the PBA predates the establishment of many JSPs and the implicit assumption that defined benefit pension plans are sponsored solely by employers gives rise to a number of practical problems for JSPs. These are:

(a) assigning responsibility for making contributions to the pension fund;

(b) selecting the most appropriate method for amortizing a going concern unfunded liability;

(c) selecting the most appropriate method for amortizing a solvency deficiency;

(d) co-ordinating special payments in respect of a going concern unfunded liability and a solvency deficiency;

(e) remitting special payments in respect of a going concern unfunded liability (or a solvency deficiency) plus interest to the pension fund from the date of the funding valuation to the date the valuation is filed with the Superintendent of Financial Services;

(f) applying actuarial gains and losses to a schedule of special payments to amortize a going concern unfunded liability or solvency deficiency which was established in the previous actuarial valuation; and

(g) paying commuted values of pension benefits earned by a terminating plan member in circumstances where the pension plan has a transfer deficiency.

2. DEFINING JOINTLY-SPONSORED PENSION PLANS

As this paper points out, the PBA predates the establishment of most JSPs and is implicitly based on the assumption that defined benefit pension plans are sponsored only by employers. Accordingly, plan funding obligations are placed on employers. If the proposals in this paper are accepted, they could be implemented more easily if a new class of pension plans was created, namely, "jointly-sponsored pension plans".

A jointly-sponsored pension plan means a contributory defined benefit pension plan in which the documents which create and support the plan provide that:

- the members of the plan are required to make contributions in respect of any going concern unfunded liability and solvency deficiency (as co-sponsors of their plan, members share in the assumption of the risks associated with the provision of a benefit the cost of which cannot be determined in advance);

- if applicable, the exceptions to the prohibition against the reduction of benefits contained in subsections 14(2) and 14(3) of the PBA are not used by the plan;

- plan members and the employer share responsibility for plan governance, plan administration and plan terms; and,

- the level of plan benefits and the amount of member contributions in respect of the plan's normal cost are directly related to the level of pensionable earnings of the plan member (the pension plan must provide defined benefits based on final average or career average earnings, given that the contribution rates are directly related to pensionable earnings).

The above definition could be implemented in one of two ways: by adding a new definition to the PBA; or by amending the PBA to provide that the class of pension plans can be defined in the Regulation. Adding a new definition to the PBA would mean that once the definition is in place, it would be more difficult to amend if required.

Amending the regulation making authority to allow for a new class of pension plans to be defined by Regulation would make future changes to the definition easier and faster. The *Income Tax Act* (Canada) and pension standards legislation in other jurisdictions deal with this issue in similar circumstances either by defining the class in the Regulations, or providing an official (typically the Superintendent of Pensions) with the authority to designate a pension plan as belonging to a particular class of pension plans (e.g., a multi-employer plan).

Proposal:

1. **Amend the PBA to provide the authority to define a new class of pension plans as "jointly-sponsored pension plans" in the Regulation.**

3. AMORTIZING A GOING CONCERN UNFUNDED LIABILITY, SOLVENCY DEFICIENCY OR TRANSFER DEFICIENCY

(a) Assigning Responsibility for Making Contributions to the Pension Fund

The requirements for funding a pension plan are contained almost entirely in the Regulation. The regulation making authority which governs the funding of a pension plan is contained in subsection 55(2). Subsection 55(2) provides in part:

An employer required to make contributions under a pension plan, or a person required to make contributions under a pension plan on behalf of an employer, shall make the contributions in the prescribed manner and in accordance with the prescribed requirements for funding ...

It is noteworthy that there is no mention of contributions made by plan members.

Subsection 4(1) of the Regulation (which governs the funding of pension plans) provides as follows:

Every pension plan shall set out the obligation of the employer or any person required to make contributions on behalf of an employer, to contribute both in respect of the normal cost and any going concern unfunded actuarial liabilities and solvency deficiencies under the plan.

Employers are required to remit all contributions received from employees to the pension fund. It is clear that employees can be required to make contributions ("contributory benefit" is a defined term under the PBA). However, there is no mention of the possibility that plan members might be required under the terms of the plan to make special payments in respect of a going concern unfunded liability or solvency deficiency.

The funding provisions which govern multi-employer pension plans are similarly worded. Subsection 6(1) of the Regulation provides in part:

A multi-employer pension plan ... shall include a provision for the funding of pension benefits and any other benefits provided under the plan that sets out the obligation of an employer or any person required to make contributions on behalf of the employer to contribute in respect of the plan.

Again, there is no mention of the possibility that plan members might be required to make contributions to the pension plan (other than for the normal cost).

Proposals:

2. **Amend the PBA and the Regulation to provide that the documents that create and support a jointly-sponsored pension plan shall provide that plan members are required to make special payments to amortize a going concern unfunded liability and solvency deficiency.**

3. **Amend the PBA and the Regulation to include plan members in the list of persons who may be required to make contributions under a pension plan (including special payments to amortize a going concern unfunded liability and solvency deficiency) and if plan members are so required to make contributions, to ensure that pension plans set out that obligation.**

(b) Amortization of a Going Concern Unfunded Liability

The PBA requires plan administrators to file two types of funding valuations with the Superintendent of Financial Services: a going concern valuation, which assumes that the pension plan will continue indefinitely; and a solvency valuation to determine whether there are sufficient assets to pay accrued benefits if the plan was wound up as of the valuation date.

Since JSPs were created mainly in the 1990s, they have not for the most part had any new unfunded liabilities to finance, and the amortization of unfunded liabilities has not been an issue. However, complying with the PBA would present practical difficulties if any unfunded liabilities were to arise in the future.

Sections 5 and 12 of the Regulation currently require that employers who sponsor defined benefit pension plans must amortize a going concern unfunded liability in the following way:

- through special payments over no more than 15 years in equal monthly instalments with interest at the going concern valuation interest rate (similar to a mortgage or consumer loan);

- payments are assumed to begin on the valuation date of the report that first discloses the going concern unfunded liability; and

- special payments in arrears are to be paid to the pension fund in a lump sum with interest within 60 days of the date of filing of the valuation (valuations must be filed no later than nine months after the valuation date).

Similarly, section 75 of the PBA imposes payment obligations on the employer in the event of a plan wind up.

The current PBA provisions raise two difficulties for JSPs if a going concern unfunded liability should arise:

- past special payments plus interest due since the valuation date would require retroactive payments from plan members (and potentially from a large group of employers) for up to a nine month period; and

- plan members receiving lower salaries would bear a heavier burden than those with higher salaries in paying according to a schedule based on equal monthly instalments. (Most JSPs base plan benefits on final average earnings. While in practice this is an administrative issue, in that the plan could levy the membership portion against the individual plan members and still meet the PBA requirement, doing so could be very difficult.)

Despite the fact that the PBA requires equal monthly instalments to finance a going concern unfunded liability, most JSPs appear to implicitly assume that a going concern unfunded liability or solvency deficiency can be amortized as a level percentage of projected pensionable earnings, thereby avoiding the above two difficulties. In a JSP, plan members are involved in the funding of benefits, both in respect of normal costs and special payments for past service. Therefore the potential payments they would be responsible for if there were a going concern unfunded liability are related to their earnings, since their benefits are usually based on their pensionable earnings.

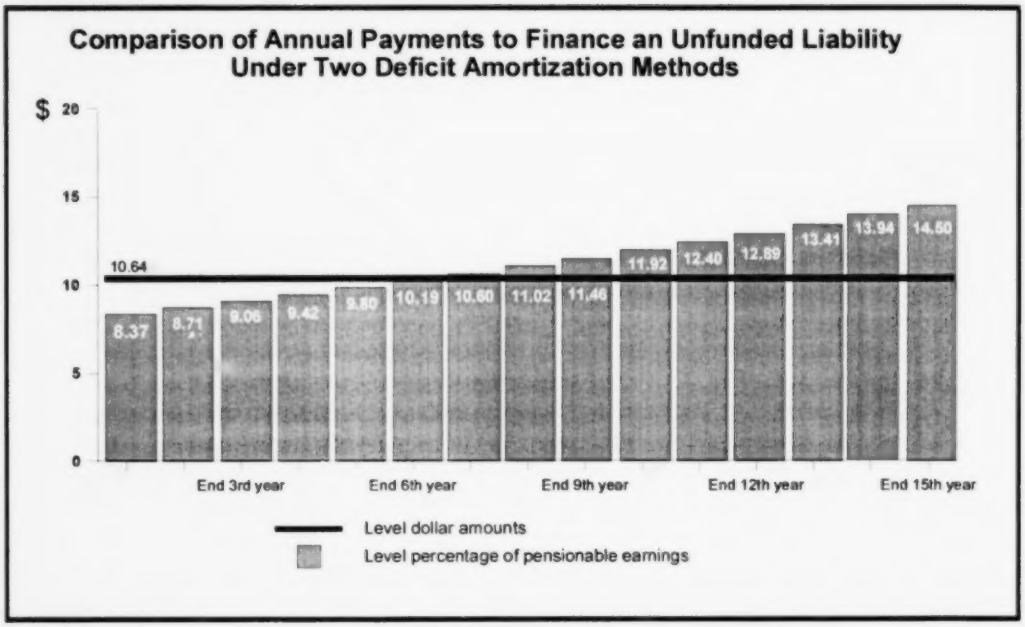
Currently, many jurisdictions in Canada permit amortization of unfunded liabilities as a percentage of projected pensionable earnings as an alternative to equal monthly instalments. Appendix I provides an excerpt from the New Brunswick Regulation under the *Pension Benefits Act* as an example.

The level percentage of pensionable earnings method implies lower payments initially and higher payments at the end of the 15 year amortization period, as Chart 1 below shows. Charts 1, 2, 3 and 4 that follow illustrate a schedule of special payments and outstanding balances under the percentage of pensionable earnings deficit amortization method. The calculations which underlie these amounts were prepared based upon rules which are in place in a number of jurisdictions in Canada, specifically:

- the projected future pensionable earnings of members at the date of establishment of the schedule is determined using the same actuarial assumptions as used in the going concern valuation through which the going concern unfunded liability was determined; and

- the present value of the scheduled payments at the date of establishment of the schedule is calculated by using the valuation interest rate and it must be equal to the amount of the going concern unfunded liability.

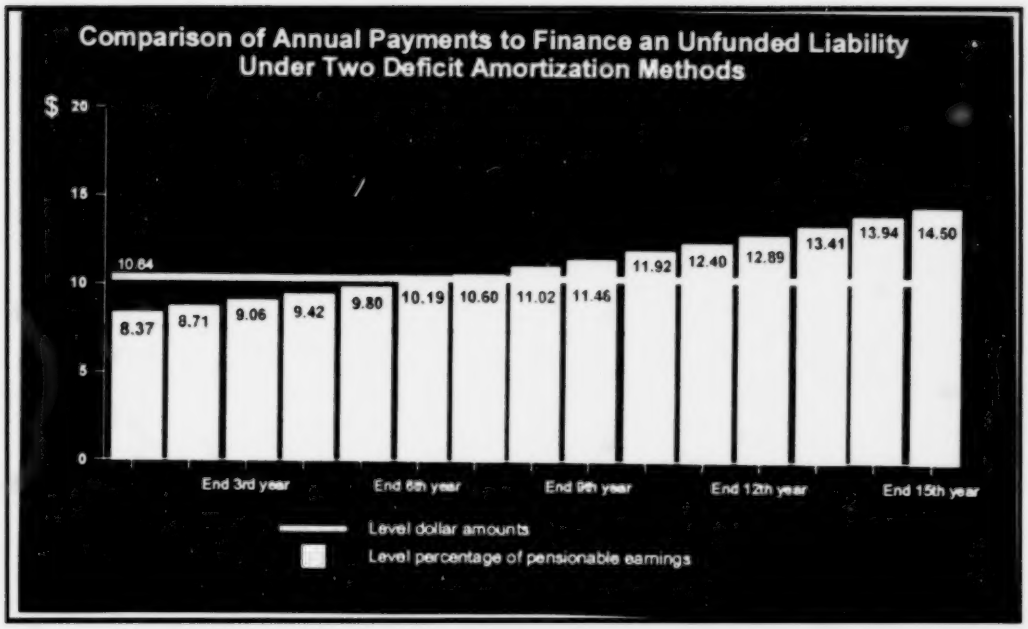
Chart 1



Note: For details of the assumptions used to derive the payments, see Appendix II.

Based upon the approach which has been adopted by other jurisdictions (of which New Brunswick is an example), the amount of the initial payment depends largely on the assumed rate of growth in wages and assumes that each member who retires or terminates is replaced with a new entrant. The going concern unfunded liability would be liquidated in the required 15-year period. In most cases, payments are sufficient, even in the early years, to cover interest so that the amount outstanding would not increase.

Chart 1



Note: For details of the assumptions used to derive the payments, see Appendix II.

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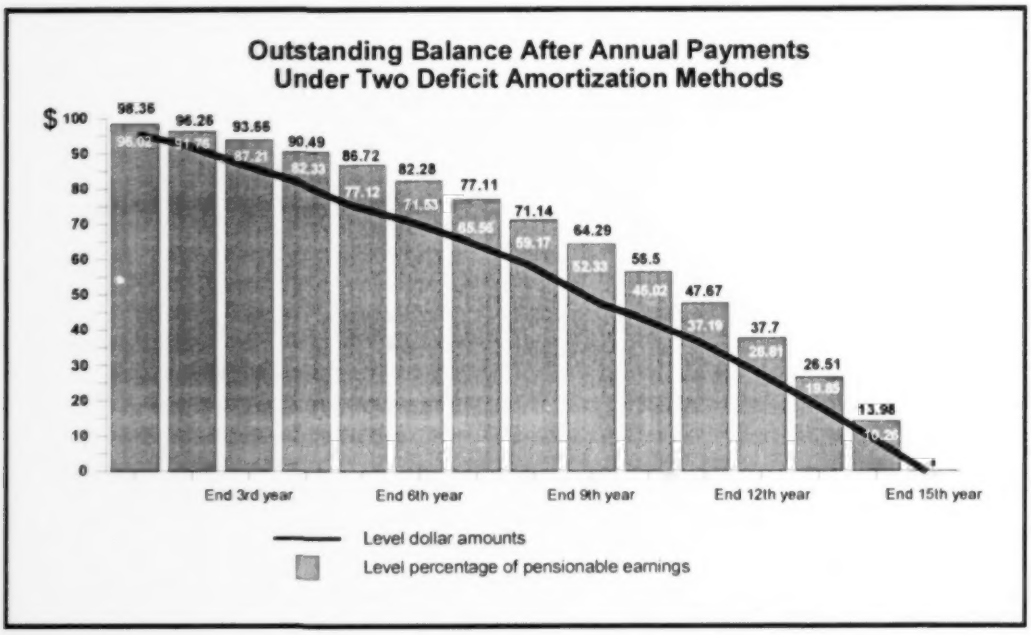
Chart 2 below shows, under both funding methods, the outstanding balance of a $100 going concern unfunded liability over this period.

Chart 2



Note: For details of the assumptions used to derive the payments, see Appendix II

It could be argued that if the plan sponsor were to become insolvent and the plan were wound up, the lower initial payments under the level percentage of projected pensionable earnings method would lead to a situation in where there would be fewer assets available to pay benefit entitlements than if equal monthly instalments had been made. However, the difference between the payments under the two methods is not large.

One consideration when employing the level percentage of pensionable earnings method to amortize a going concern unfunded liability (or solvency deficiency) is the possibility that experience will differ from the assumptions used to derive the special payments. The schedule of special payments may prove insufficient to amortize the going concern unfunded liability over the required 15 year period.

For example, assume that a pension plan is found to have a going concern unfunded liability, and the actuary assumes that projected pensionable earnings will rise by four per cent annually over the fifteen-year amortization period. If the next actuarial valuation, which is prepared three years later, reveals that pensionable earnings actually rose by only three per cent annually in each of the first three years, the special payments for

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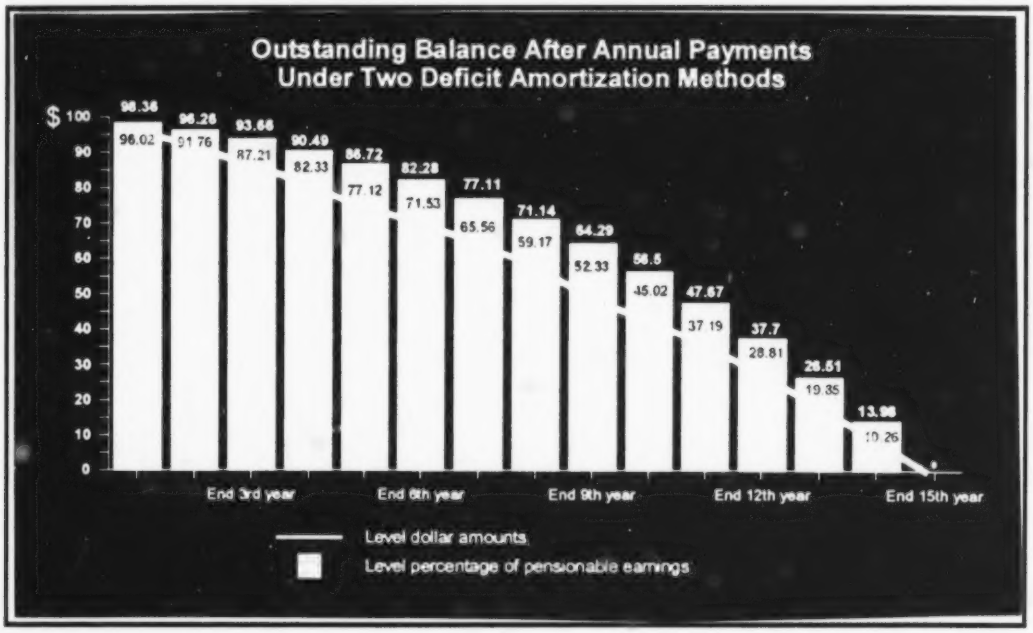


Note: For details of the assumptions used to derive the payments, see Appendix II

It could be argued that if the plan sponsor were to become insolvent and the plan were wound up, the lower initial payments under the level percentage of projected pensionable earnings method would lead to a situation in where there would be fewer assets available to pay benefit entitlements than if equal monthly instalments had been made. However, the difference between the payments under the two methods is not large.

One consideration when employing the level percentage of pensionable earnings method to amortize a going concern unfunded liability (or solvency deficiency) is the possibility that experience will differ from the assumptions used to derive the special payments. The schedule of special payments may prove insufficient to amortize the going concern unfunded liability over the required 15 year period.

For example, assume that a pension plan is found to have a going concern unfunded liability, and the actuary assumes that projected pensionable earnings will rise by four per cent annually over the fifteen-year amortization period. If the next actuarial valuation, which is prepared three years later, reveals that pensionable earnings actually rose by only three per cent annually in each of the first three years, the special payments for

these years, as well as those to be made in the next twelve years (144 monthly payments), would not be sufficient to eliminate the going concern unfunded liability.

In a final average earnings or adjusted career average earnings plan, the shortfall in financing the going concern unfunded liability due to lower than expected wage growth would be offset, in part or in whole, by a decline in a plan's liabilities. If any shortfall in financing remained, it would be necessary to establish a new 15 year amortization schedule to amortize the shortfall amount since the date of the last valuation. This means that it would take more than 15 years to pay off unfunded liabilities established earlier and the new shortfall.

If the overall experience results in an actuarial gain, the gain could be used to reduce or eliminate the schedule of special payments that was established most recently. Any remaining actuarial gains could be used to reduce or eliminate the special payments that were established in the next more recent valuation, and so on.

Proposal:

4. **Amend the Regulation under the PBA to permit both sponsors (plan members and employers) of jointly-sponsored defined benefit pension plans to finance a going concern unfunded liability by a level percentage of the projected pensionable earnings of the members of the pension plan on the date of the establishment of the payment schedule over a period not to exceed 15 years. This rate would be paid in the future by both existing members and new entrants.**

(c) Amortization of a Solvency Deficiency

A solvency valuation assumes that the pension plan is wound up, the plan assets sold and annuities purchased or commuted values paid out to settle pension obligations. The valuation basis is prescribed based upon a standard prepared by the Canadian Institute of Actuaries. The discount interest rate used for the valuation is based upon interest rates for fixed income securities, while current salaries rather than projected salaries are typically used to determine plan liabilities. A solvency valuation also takes into account "grow-in" benefits under section 74 of the PBA.

Clause 5(1)(e) of the Regulation currently requires that the sponsors of defined benefit pension plans amortize any solvency deficiency in the following way:

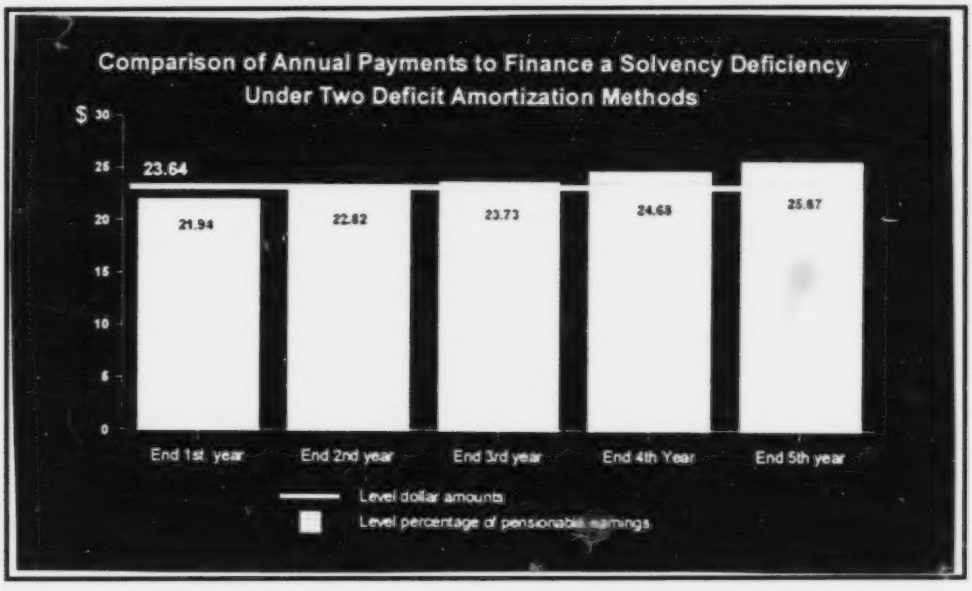
- through special payments over no more than 5 years in equal monthly instalments with interest at the solvency valuation interest rate (as in a mortgage or consumer loan); and,

- payments are assumed to begin on the valuation date of the report in which the solvency deficiency was first revealed. However, since valuations must be filed no later than nine months after the valuation date, the Regulation requires that payments in arrears be paid in a lump sum with interest within 60 days of filing.

As a result of favourable experience in the 1990s, many JSPs have not yet faced a solvency deficiency. Requiring members to make payments to fund a solvency deficiency which is not related to their earnings results in the same problem as the one discussed earlier with respect to a going concern unfunded liability. The level percentage of projected pensionable earnings method would avoid the two difficulties (retroactive payments and uneven payment burdens) that the current Regulation creates for JSPs, as discussed in the previous section.

The level percentage of pensionable earnings method in the case of a solvency deficiency also implies lower payments initially and higher payments at the end of the 5-year amortization period, as Chart 3 below shows.

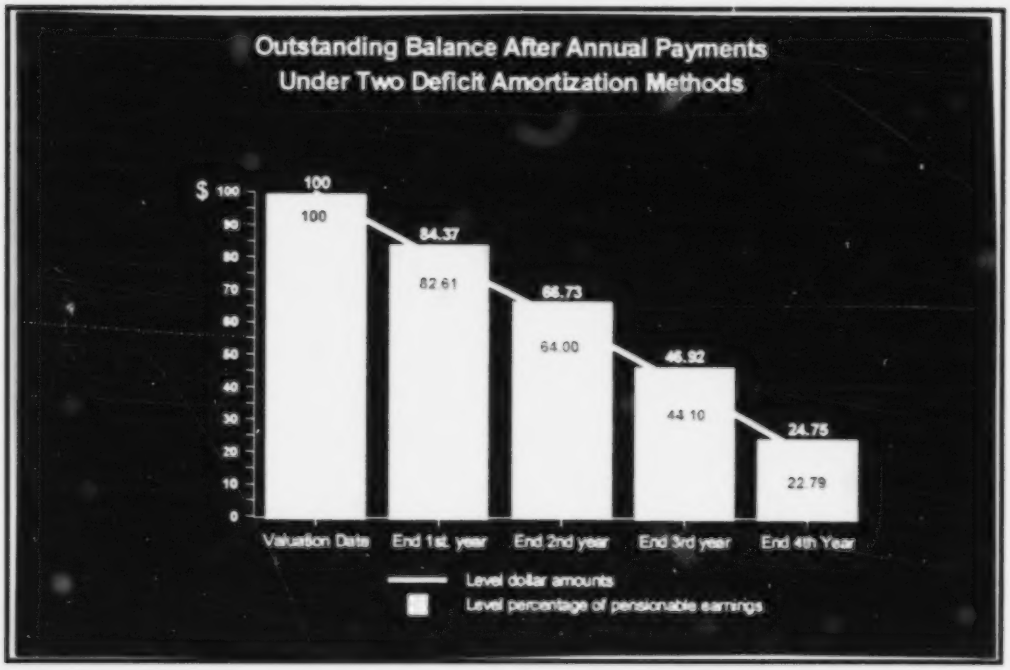
Chart 3



Note: For details of the assumptions used to derive the payments, see Appendix II.

In this example, the annual payments under the level percentage of projected pensionable earnings method exceed the payments under the flat dollar method by the third year. Chart 4 below shows, under both funding methods, the outstanding balance of the solvency deficiency over the five-year period.

Chart 4



Note: For details of the assumptions used to derive the payments, see Appendix II.

Proposal:

5. **Amend the Regulation under the PBA to permit both sponsors (plan members and employers) of jointly-sponsored defined benefit pension plans to finance a solvency deficiency as a level percentage of projected pensionable earnings of the members of the pension plan on the valuation date over a period not to exceed five years. This rate would be paid in the future by both existing members and new entrants.**

(d) Payment of Arrears

As indicated above, subsection 5(1) of the Regulation assumes that special payments to amortize a going concern unfunded liability or a solvency deficiency will begin on the valuation date of the report in which they are revealed. However, since these reports are filed up to nine months after the valuation date, subsection 12(2) of the Regulation

requires that the special payments in arrears be remitted in a lump sum plus interest within 60 days of the report being filed.

For a solely sponsored defined benefit pension plan, such a lump sum payment presents fewer practical problems as the employer usually has advance notice of the contribution amount and the deadline by which a catch-up contribution will be required. This is seldom the case for members who participate in JSPs. The employer of a single-employer plan makes a payment to the pension fund in the amount of the arrears plus interest. However, members of JSPs would be required to pay nine months of payments in a lump sum plus interest as a "catch-up" payment. The membership itself will undoubtably have changed over this period. This "catch-up" would be onerous for plan members. JSPs, many of which include a large number of participating employers, might encounter serious practical difficulties in complying with the current Regulation, since these plans could not be easily administered to deduct arrears in a lump sum from payroll.

An alternative for these plans would be to permit payments by employers and plan members in respect of a going concern unfunded liability or a solvency deficiency to be deferred by as much as one year from the valuation date (and as a result, up to three months after the filing date). No immediate lump sum "catch-up" would be required for arrears in respect of the period before the deferred commencement date.

The commencement of the series of special payments, calculated as a level percentage of projected pensionable earnings, could be deferred rather than paid in a lump sum plus interest on the filing of the valuation report. The level of the special payments could, however, take into account interest on the going concern unfunded liability and solvency deficiency for the period from the valuation date to the commencement of the special payments.

Since special payments would commence up to one year after the valuation date, it would take an additional year to pay off a going concern unfunded liability (16 years after the valuation date, instead of 15 years) or solvency deficiency (6 years after the valuation date instead of 5 years) under this option. But because interest would be added to the amortized amount, the pension fund would be unaffected by the end of the amortization period. For a tabulation of the payments under this approach, see Appendix III.

Proposal:

6. **Amend the Regulation under the PBA to permit both sponsors (plan members and employers) of jointly-sponsored defined benefit pension plans to finance a going concern unfunded liability or solvency deficiency through special payments calculated as a level percentage of projected pensionable earnings (starting no later than 12 months after the valuation date), together with appropriate adjustments for interest, rather than paying the amount in arrears as a lump sum including interest.**

(e) Actuarial Cost Methods

There are two basic actuarial cost methods. These are: cost allocation methods and benefit allocation methods. Cost allocation methods are those that allocate the cost of the projected benefits that have been earned or will be earned by plan members and/or new entrants among time periods. Costs are typically expressed as a level percentage over the working careers of members. Cost allocation methods include entry age normal, attained age normal, aggregate and individual level premium. The contribution rates determined under these methods tend to be more stable over time compared to benefit allocation methods.

Benefit allocation methods determine the cost of benefits related to a period of time as a function of the changes in the accrued benefit during the period. Benefit allocation methods include the accrued benefit (or unit credit) cost method, with or without salary projection. Typically contribution rates increase over time as the plan matures.

Benefit allocation methods determine the cost of benefits related to different periods of time as a function of the changes in the accrued benefit from period to period. Benefit allocation methods include the accrued benefit (or unit credit) cost method, with or without salary projection. Typically contribution rates increase over time as the plan matures.

Almost all non-JSPs are funded using benefit allocation methods rather than cost allocation methods. By way of contrast, some but not all JSPs are funded using cost allocation methods. The PBA Regulation implicitly assumes that all defined benefit pension plans use benefit allocation methods. The terms "normal cost" and "going concern liabilities", as defined in the Regulation, are based on the premise that pension plans are funded using a benefit allocation method. This creates some uncertainty in situations where an actuarial cost method other than the benefit allocation method is used.

The PBA does not stipulate which actuarial cost methods may be used in preparing a funding report. Subsection 16(1) of the Regulation provides only that an actuary preparing a report "shall use methods and actuarial assumptions that are consistent with accepted actuarial practice and with the requirements of the Act and this Regulation." Regardless of which method is used in a report, subsection 4(2) of the Regulation provides that contributions to a pension plan shall not be less than the sum of the normal cost and special payments for unfunded liabilities and solvency deficiencies, as determined in accordance with section 5 of the Regulation.

Subsection 4(2) must be amended to enable the comparison of that portion of the annual contributions under the cost allocation method being employed, which is attributable to past service, with the annual special payments for unfunded liabilities and solvency deficiencies determined under the Regulation.

This comparison would be made in two steps. First, the actuary would calculate the difference between the required annual contribution rate to fund the total cost of the

pension benefits and ancillary benefits under the cost allocation method and the normal cost rate as defined in the Regulation.

Second, the present value of the contributions calculated under the first step for the cost allocation method must not be less than the present value of the outstanding special payments determined under Section 5 of the Regulation. The period over which the present values are calculated would be the longest remaining amortization period of an unfunded liability and/or solvency deficiency determined under the Regulation.

In practice, only a small number of pension plans use cost allocation methods. According to the most recent funding reports filed with the Financial Services Commission of Ontario (FSCO), 12 pension plans use the aggregate cost method and 26 pension plans use the entry age normal cost method. Reports using such methods would be acceptable under the Regulation as long as they do not result in contributions which are less than the amounts determined in accordance with the Regulation. However, as noted previously, the wording of the funding requirements does result in some uncertainty.

Proposal:

7. **Amend the Regulation under the PBA to expressly permit the use of actuarial cost methods in funding reports submitted to the Superintendent that are not based on benefit allocation methods. This right would be subject to the condition that the present value of the difference between the contributions determined under the method used by the plan and the normal cost as defined in the Regulation not be less than the present value of the remaining special payments for unfunded liabilities under the Regulation, subject to the application of any actuarial gains. The period over which the present values are calculated would be the longest amortization period of an unfunded liability and/or solvency deficiency.**

(f) Co-ordination of Special Payments in Respect of a Going Concern Unfunded Liability and a Solvency Deficiency

An actuarial valuation for funding purposes may disclose a going concern unfunded liability, a solvency deficiency or both. A going concern unfunded liability must be amortized over 15 years and a solvency deficiency over 5 years. In circumstances where a pension plan has both a going concern unfunded liability and a solvency deficiency, the PBA provides rules about how the special payments are to be calculated when solvency and going concern amortization schedules overlap during the five years following the valuation date.

In brief, the amount of the annual special payments in respect of a going concern unfunded liability are determined first. The present value of the payments during the first five years after the valuation date are treated as an asset for the purposes of determining the amount of the solvency deficiency. This is called a "solvency asset adjustment" in the Regulation. The purpose of the adjustment is simply to avoid a doubling up of two sets of deficit amortization payments during the same period of time. The excess of solvency liabilities (plus adjustments) over solvency assets (plus adjustments), if any, is referred to as a solvency deficiency.

As noted previously, the PBA implicitly assumes that all pension plans use a benefit allocation method. This method makes a clear distinction between the present value of accrued benefits which were earned before the valuation date (going concern liability) and the present value of benefits which are earned in the year following the valuation date (normal cost). The Regulation defines a going concern unfunded liability as the excess of going concern liabilities over going concern assets.

A number of JSPs use a cost allocation method which does not clearly distinguish between the value of benefits earned before and after the valuation date, such as the aggregate cost method. As a result, the unfunded liability determined under such method is not the same as that defined in the Regulation and the contribution rate at any point in time does not clearly distinguish between the component which represents the normal cost and the component which represents special payments in respect of past service. This means that the aggregate cost method does not lend itself easily to computing the solvency asset adjustment as defined in the Regulation.

This, however, is not an insurmountable problem. For plans that do not use a benefit allocation method, the Regulation could be amended to require the actuary to also calculate the "going concern assets", "going concern liabilities" and "going concern unfunded liability" as prescribed in the Regulation. The solvency asset adjustment could then be determined in the same manner as prescribed in the Regulation. This would enable the determination of the prescribed minimum funding requirements for comparison with the contributions determined under the actuarial cost method which is used.

Proposal:

8. **Amend the Regulation under to PBA to require that all pension plans that are valued using a method different from the benefit allocation method, must also calculate the "normal cost", "going concern unfunded liability" and "solvency deficiency" using a benefit allocation method in order to determine the minimum funding requirements as currently prescribed.**

(g) Transfer Ratio and Transfer Deficiency

The PBA restricts a plan administrator from transferring the commuted value of a terminating member's benefits if the plan is not fully funded (i.e., the transfer ratio is less than 1.0). The transfer ratio is the ratio of solvency assets to solvency liabilities, excluding future special payments. If the transfer ratio is less than 1.0, the administrator may only transfer a percentage of the commuted value that is equal to the transfer ratio, and must pay the member the balance over no more than five years. The Regulation currently provides some exceptions to this requirement if certain conditions are met.

Clause 19(6)(b) of the Regulation permits pension plan administrators to transfer out 100 per cent of the commuted value of a pension from a pension plan that has a transfer ratio less than 1.0 if:

- the transfer deficiency for an individual is less than five per cent of the Year's Maximum Pensionable Earnings (YMPE) as defined under the Canada Pension Plan; and

- the aggregate of transfer deficiencies for all transfers made since the last review date does not exceed 5 per cent of the assets of the plan at that time.

However, subsection 19(9) further limits the applicability of subsection 19(6).

Subsection 19(9) provides as follows:

Despite subsections (3) and (6), the administrator shall not transfer the commuted value of any portion of a pension, deferred pension or ancillary benefit attributable to a benefit the liability for which was excluded in calculating the plan's solvency liabilities unless, in the report most recently filed or submitted under section 3, 4, 5.3, 13 or 14, the liability for the benefit is included in calculating the plan's solvency liabilities, or an amount equal to the commuted value of the benefit is first paid into the pension fund by an employer.

The effect of this subsection is that if a pension plan excludes, for example, escalated adjustments or plant closure benefits from the calculation of solvency liabilities, the pension plan is unable to transfer out the full commuted value even if in the aggregate the plan is very well funded on a solvency basis.

In practice, most employers of non-JSPs fund the transfer shortfall immediately, and transfer the full amount of the commuted value to the plan member immediately. It is administratively costly to track and make payments to a former plan member over a five year period and plan members would undoubtedly prefer to receive the entire lump sum at the time of termination of employment. Such an arrangement is not practical in a JSP where the employer and the plan members share in the funding of the plan. If a JSP has a transfer deficiency, it would necessitate an additional contribution from active members every time a plan member terminated from the pension plan and asked for the commuted value of his or her pension benefits. Some JSPs, such as the Teachers' Pension Plan, have been exempted from this provision of the PBA in order to avoid this problem.

The policy rationale behind some of the provisions of subsections 19(6) and 19(9) has also been criticized. It is generally well accepted that the payment of commuted values to terminating plan members should not reduce the benefit security of the remaining members and former members of the pension plan. This objective appears to be satisfied by the requirement in clause 19(6)(b), which provides that the aggregate of transfer deficiencies must not exceed five per cent of plan assets.

The rationale behind the requirement that the transfer deficiency for an individual is less than five per cent of the YMPE is less clear. The threshold (i.e., five per cent of the YMPE for 2005 ($41,100), or $2,055) is quite low. Individuals with significant credits in the pension plan would not be entitled to receive their full commuted value. For example, a commuted value of $200,000 in a plan that has a transfer ratio of 0.95 could not be transferred out in full. The transfer deficiency for this particular transfer would be $10,000, well above the PBA maximum of $2,055. Yet the amount involved might well be insignificant as compared to the total value of plan assets.

Meeting the requirements of subsection 19(9) of the Regulation is difficult for many pension plans. In that case, pension plans are not permitted to transfer out the commuted value of any portion of a benefit if the liability associated with that benefit was excluded in the calculation of the plan's solvency liabilities. At the same time, there is no linkage to the relative magnitude of the commuted value transfers to the value of plan

assets. Many pension plans which provide indexed benefits exclude the value of the escalated adjustments from solvency liabilities, so these plans would be prevented from transferring out full commuted values.

Proposal:

9. **Amend clause 19(6)(b) of the Regulation to remove the condition related to individual transfers and permit plan members to receive their full commuted value on termination of plan membership or employment if the sum of the value of all transfer deficiencies and excluded liabilities does not exceed 5 per cent of the assets of the pension plan, provided that all other PBA requirements are met, and repeal subsection 19(9) for all plans.**

Subsections 19(4) and 19(5) of the Regulation provide additional options for the transfer of commuted values depending on the funded position of the pension plan (subsection (3) is included below for continuity):

(3) Subject to subsection (4), where the transfer ratio of a pension plan is equal to or greater than one, the administrator may transfer the commuted value of a pension, deferred pension or ancillary benefit in accordance with section 42, 43, 48 or 51 of the Act.

(4) Where the administrator of a plan knows or ought to know that, since the valuation date of the report most recently filed or submitted in respect of the plan under section 3, 4, 5.3, 13 or 14, events have taken place that may result in the reduction of the transfer ratio of the plan to a value less than 0.9, the administrator shall not undertake the transfer described in subsection (3) without the prior approval of the Superintendent under subsection 42(8) of the Act.

(5) Where the administrator reasonably believes that the reduction in the transfer ratio referred to in subsection (4) is less than 10 per cent of the transfer ratio in the report most recently filed or submitted in respect of the plan under section 3, 4, 5.3, 13 or 14, the administrator may undertake the transfer described in subsection (3) without the approval of the Superintendent.

The overall goal of subsections 19(4) and 19(5) appears to be the balancing of interests of departing and remaining members of a pension plan. Currently the transfer ratio is calculated in the triennial actuarial valuation for plans. Plans with solvency concerns must file an actuarial valuation annually. These subsections address the payment of commuted values from a plan (particularly those which file every three years) when the transfer ratio may have changed. They are designed to preserve the assets of the pension fund by preventing the payment of full commuted values (based on a previously filed transfer ratio of 1.0 or more) where the transfer ratio of the plan has likely declined to a value of less than 0.9. If, on the other hand, the new transfer ratio is likely reduced by less than 10%, then the plan can continue to pay out a full commuted value based on the previously filed transfer ratio of 1.0 or more.

These provisions have been criticized for their complexity. As well, the requirement that the Superintendent consider these transfers in some circumstances, adds to the regulatory burden in an area that could, perhaps, be better addressed in another way. For example, the Superintendent's role might not be necessary if there was an objective method for determining the appropriate transfer ratio, or an estimate of the transfer ratio, to be used at the time of a commuted value transfer.

Question:

1. **Could subsections 19(4) and (5) of the Regulation under the PBA be amended in a manner which maintains the balance in interests between departing and remaining members, simplifies the requirements for plan administrators and reduces the regulatory burden? Please be as specific as possible.**

4. OTHER ISSUES RELATING TO JSPs

In addition to the funding issues identified in this paper, other administrative issues can arise in circumstances in which the employer is not the plan administrator, or the pension plan is jointly sponsored and the plan administrator is a government agency or board of trustees. A number of these issues are outlined below. There may be other issues of which stakeholders are aware of that should be included in the following list.

(a) Separate Pension Plan: Section 34

Section 34 of the PBA permits an employer to establish a separate pension plan for part-time employees if it provides reasonably equivalent benefits as an existing plan for full-time employees. This provision assumes that the employer is the sole plan sponsor and has the legal right to make this decision. In a JSP, this decision might be made by the joint sponsors of the plan.

Proposal:

10. Amend section 34 of the PBA by adding "other prescribed person or entity" in addition to an employer in order to address circumstances in which the pension plan is jointly-sponsored and the documents which create and support the plan do not assign the responsibility to establish a separate pension plan to the employer.

(b) Eligibility for Consent Benefits

Subsection 40(3) of the PBA currently provides that where the consent of an employer is an eligibility requirement for entitlement to receive an ancillary benefit and a member has met all other eligibility requirements, the employer is deemed to have given the consent to the member.

In some plans, however, particularly MEPPs, the plan text provides that the plan administrator must give the kind of consent referred to in subsection 40(3), not an employer. There is no reason why subsection 40(3) should apply to an employer's consent but not an administrator's consent, and this omission should be corrected.

Proposal:

11. Amend subsection 40(3) of the PBA to provide that where the consent of the plan administrator is an eligibility requirement for entitlement to receive an ancillary benefit and a member has met all other eligibility requirements, the administrator is deemed to have given the consent to the member.

(c) Duty to Pension Fund Trustees: Subsection 56.1(1)

Subsection 56.1(1) of the PBA requires pension plan administrators to provide pension fund trustees with a summary of contributions required to be made to the pension plan in a given fiscal year. The summary is to be provided on FSCO Pension Form 7.

In most single employer defined benefit plans, the employer is the plan administrator. However, an employer is not eligible under the Regulation to be the pension fund trustee. As a result, the plan administrator and the fund trustee are two separate bodies. By way of contrast, in the case of JSPs, the plan administrator is often also the pension fund trustee.

The Form 7 summary is intended to help trustees ensure that contributions that are expected to be made in the next year are being made. In the case of many JSPs, the administrator is also the pension fund trustee, so the need for such a summary is unclear.

In order to reduce this unnecessary administrative burden on JSPs, the requirement to provide a summary of contributions could be eliminated in these circumstances. This could be done through an exemption from this provision of the PBA for those plans in which the administrator is also the plan trustee.

Proposal:

12. Exempt a plan administrator who acts both as administrator and trustee of the pension fund from the requirement in the Regulation to provide the pension fund trustee with a summary of contributions required to be made in the next fiscal year.

(d) Winding Up: Subsection 68(1)

Subsection 68(1) of the PBA stipulates that an employer, or an administrator in the case of a MEPP, can initiate a plan wind up in whole or in part. This subsection does not appear to contemplate instances in which the pension plan is jointly sponsored or established by statute.

Proposal:

13. Amend subsection 68(1) of the PBA to provide that a pension plan may be wound up in whole or in part by the person or entity which is assigned this responsibility in the documents which create and support the pension plan.

(e) Other Issues

Question:

2. **Are there any issues relating to jointly-sponsored defined benefit pension plans which have not been covered in this paper that need to be addressed?**

5. TEACHERS' PENSION PLAN

The Teachers' Pension Plan (TPP) is a JSP and the proposed amendments would be applicable to this pension plan. However, the TPP already includes some provisions that relate to the proposed amendments. The 2005 Ontario Budget states that the funding rules which apply to the TPP would be made consistent with the rules which apply to all other Ontario pension plans. In order to achieve this objective, those funding provisions in the *Teachers' Pension Act* (TPA) that relate to the proposed amendments would be repealed at the same time that the proposed amendments to the PBA are made applicable to all JSPs in Ontario.

The TPA mandates the funding method which the TPP must use, a decision which is the responsibility of the plan administrators in other pension plans. The funding method also specifies that the value of the escalated adjustment must be included in solvency liabilities, a requirement which does not apply to other pension plans. Specifically, it is proposed that subsections 12.1 and 12.2 of the TPA which:

1. specify the information which is required to be reported in a valuation which is filed with FSCO;

2. outline the method of calculating the transfer ratio;

3. provide that plan members share in the cost of a going concern unfunded liability or solvency deficiency;

4. require that a going concern unfunded liability with an appropriate adjustment for interest be paid as a level percentage of pensionable earnings and commence one year after the valuation date without a catch up payment; and

5. require that the value of the escalated adjustment must be included in calculating solvency liabilities be repealed.

Proposal:

14. Repeal sections 12.1 and 12.2 of the *Teachers' Pension Act* on the date on which the amendments to the PBA and the Regulation come into force.

6. TRANSITION

The 2005 Ontario Budget announced that legislation to amend the PBA to address the issues identified in this paper will be introduced in the fall and, if passed by the Legislature, it is expected that the changes will be in effect by year-end. Amendments to the Regulation would also be required.

The Regulation under the PBA gives the plan administrator the ability to choose the valuation date for an actuarial valuation for funding purposes to be filed with the Superintendent of Financial Services provided that the valuation date is no later than three years after the last filed valuation date. However, for any plan for which the report last filed indicated solvency concerns, a new report is required to be filed with a valuation date no later than one year from the valuation date last filed.

The administrators of some JSPs have indicated that the funded position of their plans has deteriorated since the last filed valuation. They would like to file another funding valuation before the mandatory triennial valuation (an inter-valuation report) in order to advance the timing of a contribution rate increase.

Valuation reports must be filed within nine months after the date of the last filed valuation. Given that the proposed amendments to the PBA and the Regulation are unlikely to be in effect until late in the fall of 2005, they would not apply to valuation reports for prior time periods. As a result, these plans are of the view that they could not easily comply with some of the PBA requirements such as the amortization of a going concern unfunded liability or solvency deficiency in equal monthly instalments and the requirement to pay any amount in arrears as a lump sum within two months of the date of filing.

In the Ministry's view, plan administrators should not be discouraged from filing an inter-valuation report in order to advance the timing of a contribution rate increase. Advancing the timing of a contribution rate increase would improve the security of plan benefits.

Proposal

15. **Amend the PBA to extend the deadline for filing actuarial valuations for inter-valuation reports with a valuation date between December 31, 2004 and June 30, 2005 until March 31, 2006 and apply the proposed amendments in this Consultation Paper to those valuations which are filed by the new deadline for jointly-sponsored defined benefit pension plans only. Specific details will be included in the legislation to be introduced this fall.**

APPENDIX I

Excerpt from the New Brunswick Regulation

The following is an excerpt from the New Brunswick Regulation under the Pension Benefits Act (O. C. 91-1060) relating to the use of the percentage of pensionable earnings method for the amortization of a going concern unfunded liability or a solvency deficiency.

36 (5) Subject to subsection 41(1), an employer or person required to make contributions on behalf of an employer may, instead of making the special payments required under paragraphs (1)(b) and (c), make scheduled dollar payments in accordance with subsections (2), (3) and (4) in monthly installments that

(a) commence as of the review date of the actuarial valuation report in which the actuarial loss or solvency deficiency is identified, and

(b) are determined by reference to a schedule of dollar payments determined in accordance with subsection (6).

36(6) A schedule of dollar payments referred to in subsection (5) shall be determined so that

(a) each scheduled dollar payment is a consistent percentage of the projected future payroll of members, as projected at the date of establishing the schedule,

(b) the present value of the scheduled dollar payments is equal to the total amount of any actuarial loss and any solvency deficiency to be liquidated at the date of establishing the schedule,

(c) if there is an actuarial loss, the projected future payroll is determined using the same actuarial assumptions used in the going concern valuation in which the actuarial loss was identified, and

(d) the amortization period for each series of scheduled dollar payments is not greater than the periods provided for under paragraph (1)(b) or (c), as the case may be.

36(7) For the purposes of paragraph (6)(b), the present value of scheduled dollar payments shall be determined

(a) for scheduled dollar payments relating to an actuarial loss, using the interest rate assumed in the going concern valuation, and

(b) for scheduled dollar payments relating to a solvency deficiency, using the interest rate assumed in the solvency valuation.

APPENDIX II

Details of Assumptions

Assumptions used to calculate the payments and outstanding balances in Charts 1 to 4 in the body of the paper and Tables A1 and A2 in Appendix III are provided below:

Initial loan amount:	$100
Annual pensionable earnings at valuation date:	$1,000
Annual interest rate:	7%
Annual salary increase scale:	4%

APPENDIX III

Comparison of Special Payments to Amortize a $100 Solvency Deficiency and Unfunded Liability

Tables A1 and A2 below compare the pattern of payments, both in level dollar amounts and as a level percentage of projected pensionable earnings for a solvency deficiency and going concern unfunded liability, respectively.

Table A1 compares the payments under the current PBA provisions to the alternative of deferring the commencement of the special payments by one year and amortizing the solvency deficiency over 5 years.

Table A2 compares the payments under the current PBA provisions to the alternative of deferring the commencement of the special payments by one year and amortizing the going concern unfunded liability over 15 years.

Table A1

COMPARISON OF SPECIAL PAYMENTS TO AMORTIZE A $100 SOLVENCY DEFICIENCY*

	1st Year	2nd Year	3rd Year	4th Year	5th Year	6th Year
Current PBA requirement						
(1) level $ amounts	23.64	23.64	23.64	23.64	23.64	0
Alternative assuming payments begin one year after the valuation date for a 5-year term						
(2) level % of earnings in dollars	0	23.47	24.41	25.39	26.41	27.46
difference (2) – (1)	-23.64	-0.17	0.77	1.75	2.77	27.46

* For details of the assumptions used to derive the payments, see Appendix II.

Table A2

COMPARISON OF SPECIAL PAYMENTS TO AMORTIZE A $100 GOING CONCERN UNFUNDED LIABILITY*

	1st Year	2nd Year	3rd Year	4th Year	5th Year	6th Year	7th Year	8th Year	9th Year	10th Year	11th Year	12th Year	13th Year	14th Year	15th Year	16th Year
Current PBA requirement																
(1) level $ amounts	10.64	10.64	10.64	10.64	10.64	10.64	10.64	10.64	10.64	10.64	10.64	10.64	10.64	10.64	10.64	-
Alternative assuming payments begin one year after the valuation date for a 15-year term																
(2) level % of earnings in dollars	0.00	8.96	9.32	9.69	10.08	10.48	10.90	11.34	11.79	12.26	12.75	13.26	13.79	14.35	14.92	15.52
difference (2) - (1)	-10.64	-1.68	-1.32	-0.95	-0.56	-0.16	0.26	0.70	1.15	1.62	2.11	2.62	3.15	3.71	4.28	15.52

* For details of the assumptions used to derive the payments, see Appendix II.